

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF JACKSON COUNTY)	
RURAL ELECTRIC COOPERATIVE CORPORATION)	
FOR AN AMENDMENT TO PRIOR ORDERS OF THE)	CASE NO. 92-264
COMMISSION AUTHORIZING ISSUANCE OF)	
EVIDENCE OF INDEBTEDNESS)	

O R D E R

On June 22, 1992, Jackson County Rural Electric Cooperative Corporation ("Jackson County") filed a request that the Commission amend its prior Orders entered in Case No. 6286,¹ Case No. 6501,²

¹ Case No. 6286, The Application of the Jackson County Rural Electric Cooperative Corporation for Authority to Borrow From the United States Government \$1,956,000.00 and \$838,000.00 From the National Rural Utilities Cooperative Finance Corporation (CFC) and to Execute Its Mortgage Note or a Series of Mortgage Notes to Secure the Same, Order dated July 10, 1975.

² Case No. 6501, The Application of the Jackson County Rural Electric Cooperative Corporation for Authority to Borrow From the United States Government \$976,000.00 and \$419,000.00 From the National Rural Utilities Cooperative Finance Corporation (CFC) and to Execute Its Mortgage Note or a Series of Mortgage Notes to Secure the Same, Order dated March 19, 1976.

Case No. 7365,³ Case No. 8852,⁴ and Case No. 10148⁵ to authorize the conversion from a fixed to a variable interest rate for National Rural Utilities Cooperative Finance Corporation ("CFC") Loan Nos. 9006, 9008, 9015, 9021, and 9022. The terms of these 35-year loans originally provided for a fixed interest rate for the first 7 years, after which, the rate would be renegotiated. Since the execution of these loans, interest rates have been substantially reduced and CFC has allowed borrowers to convert to a reduced variable interest rate. The current fixed interest rate for these loans was 9.5 percent, 9.5 percent, 9.0 percent, 9.5 percent, and 9.75 percent, respectively. The variable rate applicable for these loans is 5.5 percent. On May 8, 1992, Jackson County's Board of Directors voted to convert to the variable rate.

When converting from the fixed rate program to the variable rate program, CFC requires the payment of a conversion fee. The conversion fee for each loan is based on the difference in the

³ Case No. 7365, The Application of the Jackson County Rural Electric Cooperative Corporation for Authority to Borrow From the United States Government \$3,702,000.00 and \$974,000.00 From the National Rural Utilities Cooperative Finance Corporation and to Execute Its Mortgage Note or a Series of Mortgage Notes to Secure the Same, Order dated April 16, 1979.

⁴ Case No. 8852, The Application of the Jackson County Rural Electric Cooperative Corporation for Authority to Borrow From the National Rural Utilities Cooperative Finance Corporation (CFC) and to Execute Its Mortgage Note or a Series of Mortgage Notes to Secure the Same, Order dated July 20, 1983.

⁵ Case No. 10148, The Application of Jackson County Rural Electric Cooperative Corporation for Authority to Borrow From the National Rural Utilities Cooperative Finance Corporation and to Execute Its Mortgage Note or a Series of Mortgage Notes to Serve the Same and for a Certificate of Public Convenience and Necessity, Order dated March 29, 1988.

interest rate on the note and CFC's long-term interest rate at the time the borrower elects to convert to the variable rate. The difference is applied to the outstanding loan balance at the start of the borrower's next first full quarterly billing cycle for the time remaining until a repricing option would have been allowed. A one-time, up-front fee of 25 basis points on the outstanding balance at the time of conversion is added to the conversion fee. The conversion fee could be paid either in quarterly payments or as a discounted up-front payment. The total conversion fee would be \$288,193 if paid quarterly and \$248,152 if paid up-front.

Jackson County provided a series of Internal Rate of Return ("IRR") analyses for each loan it proposed to convert. Under the IRR approach, the goal of the borrower would be to utilize the interest rate program which produces the lowest IRR. For each loan, Jackson County determined an IRR value for the following three different scenarios:

1. The current variable rate remained constant for the remainder of the pricing cycle ("Scenario I").

2. The current variable rate would begin increasing by .25 percent each quarter, beginning with the third quarter after conversion, for the remainder of the pricing cycle ("Scenario II").

3. The third scenario involved determining the variable interest rates which, when applied beginning with the third quarter after conversion, would result in an IRR value approximately equal to the IRR value resulting from the current fixed interest rate. Jackson County considered this the break-even scenario.

Each scenario was run twice showing the impact on the IRR value of each payment option chosen for the conversion fee.

The analyses indicated that, under either Scenario I or II, the resulting IRRs for the variable interest rate were lower than the IRR for the fixed interest rate. The scenario results also indicate it is beneficial to Jackson County to pay the conversion fees up-front rather than quarterly. Scenario I resulted in a net cumulative savings of \$313,988 when the conversion fees were paid up-front and \$273,947 when the conversion fees were paid quarterly. Scenario II resulted in a net cumulative savings of \$42,522 when the conversion fees were paid up-front and \$2,481 when the conversion fees were paid quarterly. The net savings were lower in Scenario II because four of the five loans had 15 or more quarters remaining in the current pricing cycle. Under the assumptions incorporated in Scenario II, the increasing variable interest rate on individual loans resulted in significantly lower savings and in some instances a net increase in cost, when the conversion fee was paid quarterly.

In its request, Jackson County indicated that it would pay the conversion fees over several periods due to its current cash position. Jackson County stated that it viewed the assumptions in Scenario II to be a "worst case" scenario. While stating that it did not see variable interest rates increasing or decreasing dramatically in the next few months, Jackson County would continue to monitor interest rates and whenever indicators showed it to be advantageous, it would lock into a fixed rate. Based upon Jackson

County's analyses and the conditions presented in this case, the conversions of the five loans should result in interest savings on an IRR basis and the loans should be converted as requested.

As indicated in its request, Jackson County informed the Commission of its intent to convert these loans in a letter dated May 26, 1992, effective on June 1, 1992. The Commission advises Jackson County that in the future requests to convert loans should be made in advance of conversion, with sufficient time provided to allow for adequate review.

IT IS THEREFORE ORDERED that:

1. The Commission's Orders entered in Case Nos. 6286, 6501, 7365, 8852, and 10148 be and they hereby are modified to authorize the conversion from a fixed to a variable rate program for CFC Loan Nos. 9006, 9008, 9015, 9021, and 9022.

2. Jackson County shall notify the Commission of the closing date of the conversions and shall file, within 30 days of the conversions, all documents pertaining thereto.

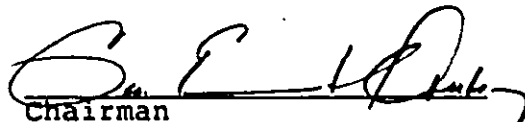
3. Jackson County shall file, along with its monthly financial report to the Commission, the current interest rate on its variable rate loans outstanding.

4. All provisions of the Commission's Orders entered in Case Nos. 6286, 6501, 7365, 8852, and 10148 shall remain in full force and effect.

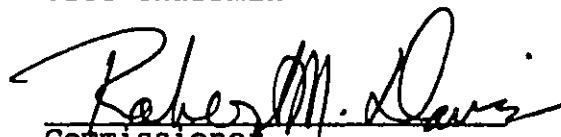
Done at Frankfort, Kentucky, this

1st day of July, 1992.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director, Acting